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SUBJECT: USDOC BIS Under Secretary McCormick Visit to South China

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11. (SBU) SUMMARY: While in Guangzhou, USDOC BIS Under Secretary David McCormick gave a speech at Huawei

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Technologies, Inc. Training Center, met with the Guangdong American Chamber of Commerce (AmCham) Board of Governors, and conducted a site visit to True Temper Composite Material Products (Guangzhou) Co., Ltd, a golfing products manufacturer. Huawei Vice President Fei Ming regaled U/S McCormick with claims of how open Huawei is, but stopped short of providing details in his responses to a number of inquiries. Huawei employees attending U/S McCormick's speech showed they were interested in his opinions on how Huawei could do better in the face of globalization. Representatives of a number of American companies attending the AmCham dinner with U/S McCormick discussed their progress in China, tactics they have adopted to deal with IP violations, and touched on some other challenges such as port security and a new Chinese labor law. The delegation's final stop in Guangzhou - the True Temper sports production line - revealed responsible and successful use of graphite composite materials in a market beneficial to U.S. exports.
END SUMMARY

12. (U) During a visit to Guangzhou on May 18-19, Under Secretary of Commerce for Industry and Security David

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McCormick gave a speech at Huawei Technologies, Inc. Training Center, met with the Guangdong AmCham Board of Governors, and conducted a site visit to True Temper Composite Material Products (Guangzhou) Co., Ltd. U/S McCormick became the first USG official to give a speech at Huawei.

"Open" But With Chinese Characteristics

13. (U) Before the speech, Huawei Vice President Fei Ming hosted a lunch for U/S McCormick, during which Fei mentioned the claim that Huawei is China's "most open" company. Fei recounted how Huawei never turns down requests by potential

customers and partners as well as foreign officials who want to visit the company's headquarters in Shenzhen. He also emphasized the fact that Huawei has more international partners than any other Chinese company. Fei explained that in order to build brand recognition from scratch, Huawei had no choice but to open itself up to potential customers and partners who wanted to visit and make sure the company has the capacity to deliver on its promises.

¶4. (SBU) In the course of conversation, U/S McCormick raised a number of questions as follow-up to various stories reported in the media about Huawei over recent months. In response to U/S McCormick's inquiry about the status of Huawei's reported intentions to acquire UK's Marconi, Fei stated that Huawei had made contact with Marconi but was unsuccessful in the acquisition. He did not elaborate or provide any details on when or why Huawei's acquisition attempt failed. U/S McCormick commented that he had heard Huawei was unique among Chinese companies in that it had a sizeable number of employees who were foreigners. Fei explained that Huawei employs many foreigners in its overseas offices, but so far only Indian nationals have agreed to come to China to work at Huawei headquarters. (Note: This seems to contradict Econoff's experience from talking to different Huawei officials at the various events in the past, who stated that foreigners working at Huawei headquarters come from India, Russia, Canada, the United States, and some European countries. The delegation saw Caucasians at Huawei wearing employee badges during the visit and one even attended U/S McCormick's speech. End Note.)

¶5. (SBU) U/S McCormick also brought up the issue of intellectual property (IP), noting that the media reported a few months ago that Huawei won a lawsuit against infringers. Fei remarked that the company has learned that the most successful countermeasure against IP infringers is to take them to court. At the same time, Huawei is taking steps to intensify internal security measures to prevent leaks of IP

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by employees and to make sure all its IP are patented on a timely basis. According to Fei, in addition to the case reported in the media, Huawei is also involved in another two ongoing IP-related lawsuits. However, he did not elaborate or provide any details other than the fact that both lawsuits were filed in Shenzhen.

Globalization On Top Of Huawei Employees' Minds

¶6. (U) In his speech to approximately 200 Huawei employees in an auditorium at the Huawei Training Center, U/S McCormick discussed the opportunities and challenges in the crucial areas of security, globalization, and technology revolution. U/S McCormick stressed the importance of winning the War on Terror and stopping the proliferation of weapons of mass destruction (WMD), while at the same time working to encourage legitimate high-tech trade, strengthen the protection of IP throughout Asia, and increase the flow of high technology to ensure continued innovation.

¶7. (U) During the ensuing Q&A session, Huawei employees asked U/S McCormick for suggestions on how the company should change internally to meet the challenges brought about by globalization. U/S McCormick reiterated his point about the importance of IP protection. Huawei is arguably one of China's best known brands in the United States. Further progress would require the development of new proprietary technologies, so it would be in Huawei's interest to remain committed to the protection of IP. Huawei employees also asked U/S McCormick to comment on the impact globalization had on the Sino-U.S. relationship vis--vis high tech trade and the future of export controls restrictions on dual-use technologies. U/S McCormick noted that high tech trade benefits both countries, but it is

usually hampered by poor IP protection and the risk of sensitive dual-use technology being diverted to military use. Pointing to the creation of the Strategic Trade and High Technology Working Group at the most recent round of the U.S.-China Joint Commission on Commerce and Trade (JCCT) talks, U/S McCormick remarked that while the U.S. and China may not always agree, they were at least candid with each other, so the new working group should help facilitate further dialogue, which should subsequently improve the bilateral trade in civilian high-tech goods and services.

FedEx Creating Its Own Path

¶8. (U) During a dinner with the Board of Governors for the Guangdong American Chamber of Commerce (AmCham), U/S McCormick outlined the Bureau of Industry and Security's (BIS) mission and briefly described the purpose of his trip to China. AmCham President Harley Seyedin provided a general overview of the economic situation in South China, with an emphasis on the role played by U.S. companies.

¶9. (SBU) Alex Yim, Managing Director of South China Region for Federal Express (FedEx), noted that there has been a significant shift recently in the responsiveness of the Chinese Customs officials he deals with. According to Yim, the Central Government has been pushing China Customs to focus more on contributing to the economic development of the country. To that end, China Customs has reached out to FedEx for assistance in creating benchmarks for a new model for customs clearance procedures that would help facilitate trade. Later during the dinner, when U/S McCormick solicited the audience's input on why U.S. companies are not exporting more to China, Yim noted that in addition to the language barrier, many American companies do not bother to invest the resources necessary to research what specific types of products are in demand vis--vis the ever-changing purchasing power of the Chinese market. Yim also recounted an example of how FedEx is working to resolve the problem of the serious shortage of airplane mechanics in China. The company is cooperating with the University of Tianjin's Civil Aviation Department to develop and help fund a new curriculum to get more qualified airplane mechanics into the job market over the next few years.

Export Controls Do Affect U.S. Companies In China

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¶10. (SBU) On the topic of U.S. export controls, Owen Ley, Managing Director of True Temper Composite Material Products (Guangzhou) Co., Ltd., commented that his company is very satisfied with how USDOC's export licensing process has shortened dramatically since two years ago when it took as long as seven months to obtain an export license. Stella Liu of IBM China, Guangzhou Branch, noted that there is considerable local demand for high performance computers. Unfortunately, IBM cannot meet this demand because U.S. export control laws preclude the sale of such technologies.

U.S. Companies Get Creative To Obtain Better IP Protection

¶11. (SBU) In response to U/S McCormick's query on what results American companies are seeing in China's effort to increase IP protection, Yvonne Pei, Director of External Relations for Procter & Gamble (China) Ltd. (P&G), led the discussion by noting that for many years, an average of 20 percent of P&G products in China were counterfeits. Two years ago, that rate dropped to eight percent, but now it stands at approximately twelve percent. Pei explained that the major difference between P&G's battle against counterfeits and that of Louis Vuitton (LV), for example, is that when Chinese consumers buy a fake LV bag, they know they are buying a counterfeit and are therefore doing so

willingly. With P&G products, however, there is no way for consumers to tell the counterfeit products from genuine ones because they are all sold at the same prices. To make things even more complicated for P&G, unlike fake LV bags, there is a potential for counterfeit P&G products to cause physical harm to consumers. Pei stated that while the Central and provincial governments are willing to contribute to the effort to fight IP violations, the problem is usually with the local protectionism found at the town and village levels. This is often due to the fact that most counterfeiting factories employ large numbers of the local populations, therefore making it difficult to convince local authorities to close those factories.

¶12. (SBU) Pei also noted that P&G is lobbying the Chinese government to change its laws to allow for factory production line equipment, in addition to molds, to be confiscated during raids. She provided the example of how in the 150 raids conducted every month on factories making counterfeit P&G products, P&G has repeatedly seen the pattern of the same 20 factory owners simply moving their equipment to another location and continue producing counterfeits. To help win over local government officials, P&G has developed the strategy of conducting research on the impact counterfeiting has on potential tax revenues, the results of which the company then presents to the local government authorities to enlist their assistance in putting counterfeiters out of business.

¶13. (SBU) Seyedin suggested that instead of just continuous lobbying for more to be done, USG should also begin making public acknowledgements of some of the progress China has made so far in IP protection. True Temper's Ley remarked that some of the success his company was able to achieve in the IP arena can be attributed to an adjustment in their marketing and advertising campaigns. For example, when Chinese golfers learn that their performance on the golf course is directly related to whether they use genuine or counterfeit True Temper golf clubs, it is enough to convince them to stay away from the counterfeits and invest more to buy the genuine clubs. Brian Ma, whose company -- Shenzhen Pacific Investment Co. Ltd. -- is putting together an investment project to set up a pharmaceutical company, mentioned that he has been working with U.S. patent holders to arrange for the legal transfer of certain IP's so that all parties can benefit.

Other Challenges U.S. Companies Must Face

¶14. (SBU) Charles Hubbs of Guangzhou Fortunique Limited, a medical instruments manufacturing and consulting company, commented that while IP protection is an ongoing concern, he

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and his clients have recently encountered a number of similar experiences with delays in clearing U.S. ports due to new security measures. He remarked that many companies have reached a point where they are willing to pay additional fees to get their shipping containers inspected at loading so that the containers can get expedited clearance upon arrival at U.S. ports. Hubbs also suggested that in order for American companies to be successful in China, they must establish a physical presence to show their customers that they are willing to stay in the China market on a long-term basis. Seyedin recounted some of the proactive measures the French and Italian governments have taken to generate more export revenues. One example Seyedin provided was how both of those governments actively recruited small and medium-sized enterprises (SME) to attend the annual SME Fair in China. He suggested USG should look into similar efforts.

¶15. (SBU) Pei remarked that P&G is the number one taxpayer for light industry in China and with every job the company creates, ten jobs are created upstream and ten jobs are

created downstream. Despite all its contributions to the Chinese economy, P&G, like other foreign-invested companies, now faces a new formidable challenge with a proposed labor law requiring them to deposit RMB 5,000 (approx. USD 625) per employee in an escrow account as unemployment insurance and to give all contractors permanent positions after one year of work. Pei explained that considering P&G's size, the company would have to put out approximately USD 60-65 million just for the escrow accounts and see their costs increase dramatically with the new requirement to turn independent contractors into permanent employees.

Site Visit To True Temper: A "Hole-In-One"

¶16. (SBU) While in Guangzhou, U/S McCormick also visited the True Temper Composite Material Products (Guangzhou) Co., Ltd. factory to inspect True Temper's use of composite materials for sports equipment production. The graphite composite materials are made up of very fine carbon molecules that have dual-use capability in a number of military applications. True Temper uses the light, durable composite material in their production of golf clubs, hockey sticks, and bicycle frames. The Managing Director, Owen Ley, briefed the delegation that True Temper (headquartered in Memphis, Tennessee), is a medium-sized company at \$120 million revenue a year. Of its approximately 1,000 employees, 520 are located in Guangzhou. Daily current production quantities are about 10,000 golf shafts, 1,000 hockey shafts and 150 bicycle frames. Notably, this company is owned by a U.S. private equity firm.

¶17. (SBU) U/S McCormick inspected the log and tracking system True Temper uses to manage its supplies of controlled composite materials. Last year True Temper imported 64 metric tons of U.S.-made high module graphite, a controlled item. U/S McCormick seemed quite impressed with the professional management of the composite materials and the overall success of the company. While the golf club industry in general usually has stable but low growth, True Temper grew by 60 percent in 2005 and currently has 90 percent growth in 2006. This growth had led to the creation of considerable purchases of U.S.-made products -- USD 15 million in composite materials and USD 1.4 million in other supplies (such as paint, molds and heat transfers).

¶18. (SBU) True Temper's labor standards also seemed adequate. The factory floor had plenty of space, light and air. Most of the workers were wearing safety glasses and earplugs, while paint specialists wore special air-filtration masks. The average worker made approximately RMB 3,000 per month (USD 375), which is more than three times the minimum wage for Guangzhou (RMB 900 per month, or USD 112). However, workers must earn these wages with long hours. Ley openly admitted that work shifts - particularly during the peak season in the spring and around Christmas - were ten hours a day, six days a week. Such figures exceed national limitations of 36 overtime hours a month.

¶19. (U) Both Embassy Beijing and U/S McCormick have cleared

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this cable.

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